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C O N F I D E N T I A L SECTION 01 OF 03 ANKARA 004528

SIPDIS

TREASURY FOR INTERNATIONAL AFFAIRS - MMILLS AND MSHWARZMAN
STATE FOR E, EUR/SE, AND EB/IFD
NSC FOR MBRYZA AND TMCKIBBEN

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TAGS: EFIN ECON PGOV ECIN TU
SUBJECT: IMF OFFICIAL ON GOT'S DECISION TO SEEK A NEW DISBURSING STANDBY

REF: ANKARA 4455

Classified By: ACTING ECONOMIC COUNSELOR ANDREW SNOW FOR REASONS 1.4 (B) AND (D).

¶1. (C) Summary: Following IMF Mission Chief Moghadam,s surprise visit to Ankara last week, and public statements by PM Erdogan and Economy Minister Babacan that the GOT had decided to seek a follow-on disbursing Standby Arrangement(SBA), Econoffs met with IMF Deputy Resident Representative Christoph Klingen on 10 August. Klingen confirmed that the GOT had informed the IMF that Turkey would seek a follow-on disbursing SBA. The IMF was not informed of the GOT decision, however, until the end of the Moghadam visit, which centered on the GOT,s internally-developed three-year program for economic policy for 2005-2007. According to Klingen the GOT program was much more of a financing framework with macroeconomic targets than a policy program, as it gave a detailed picture of financing gaps for the next three years but was very limited in terms of specific policy reform measures to be taken during the same period. Klingen said the GOT, using reasonable assumptions, has identified a cumulative three-year financing gap of between $8 and $20 billion, for which it would seek IMF financing, with the key variable in the size of the gap being the primary surplus. Klingen emphasized that these numbers are extremely sensitive and close-hold. He said the IMF staff tried to dampen GOT expectations, particularly since Fund staff is not yet authorized to begin negotiations on a new program. Klingen briefly touched on the issues of the current account deficit and the 2005 budget as well, and predicted 2004 growth could be between 7 and 8 percent. End Summary.

Surprise mission

¶2. (Sbu) Although portrayed as a last minute visit to Ankara on the invitation of State Minister of Economy Ali Babacan, Klingen said Moghadam,s mission had actually been in the works for some time. The GOT requested an August mission some time ago in hopes of being able to react to a Fund proposal for a new program. The Fund was not comfortable with this approach, preferring that the Turks create ownership of any new program by first developing it on their own and then presenting it to the IMF. The Turks seem to have agreed with the IMF approach, as the focus of the mission was for the GOT to present its internally-developed three-program (reftel) to the IMF, rather than vice-versa.

¶3. (Sbu) Klingen explained that the announcement of the mission was made only just before Moghadam,s departure from Washington in order to prevent the board discussion of the 8th review of the current Stand-By arrangement from being more of a discussion on a potential future program. The IMF preferred instead that the board focus on the details of the 8th review.

¶4. (Sbu) The mission focused almost exclusively on looking at the GOT three-year program. The subject of a successor SBA was only broached in the waning hours and only in so far as the Turks stated they wished to seek one; &the details of a new SBA were not discussed8, said Klingen. However, he then described that because the GOT program was largely a demonstration of the financing gaps that Turkey would face over the next three years, the Fund had to be careful only to listen and offer general comments rather begin a negotiation. (Note: the Fund cannot formally begin negotiations with an exceptional access country like Turkey until it receives explicit permission from the board.) The IMF did feel compelled, though, to try and lower expectations about how flexible it could be in any negotiations, particularly with regard to the amount of funding it could offer
and flexibility in setting program targets, both structural

and quantitative.

Financing Gaps

¶5. (C) The GOT presented a financing framework that produced a range of financing gaps based on differing scenarios for the primary surplus. Klingen commented that it seemed thorough, coherent and &quite neatly done. Using central government primary surplus scenarios ranging from 4%-5% of GNP (these figures correspond to consolidated public sector primary surpluses of 5.5%-6.5% of GNP), the framework produced financing gaps, cumulative for the next three years ranging from $8 billion-$20 billion. Note: Klingen repeatedly stressed how sensitive these numbers are. He said that because of the danger of leaks, that only a small group in Turkish Treasury and only Minister Unakitan in the Ministry of Finance were party to these numbers. In a subsequent briefing to western diplomats, Klingen did not reveal these numbers. End Note. These results assume the following set of conditions:

Ex-ante domestic debt market rollover ratio of 92%-93%
World Bank high case lending scenario
No bilateral loan from the U.S.
$1 billion in combined privatization proceeds and SDIF assets sales per year
$5 billion in Eurobond issuance per year
Real interest rate of 8%
GNP growth of 5%
2005 Exchange rate of 1.67 new TL/$ (TL 1,670,000/$)
Current account deficit of 3% of GNP
Moving $4 billion of Fund repayments from ,06-,07 (although this makes no difference to the cumulative three-year financing gap)

¶6. (C) Klingen said that for the IMF,s purposes, the upshot of these results is that it will be very difficult for Turkey to target anything but a 6.5% primary surplus for the consolidated public sector (5% for the Central Government). Speaking again about the Fund,s lack of flexibility, Klingen remarked that he was not sure the GOT understood that it is very difficult to ask the Fund to fill a gap resulting from a lower primary surplus. He predicted that board members would not be happy to provide financing that allows for looser fiscal policy.

What the GOT 3-year program is not

¶7. (Sbu) Other than the financing framework, the three-year program appeared to the Fund to be light on specifics. Particularly on matters such as fiscal structural reform, the banking sector and improving the investment climate there was no description of the underlying policies that would allow them to achieve the quantitative targets they had laid out.

GOT Leadership Confirms its Decision

¶8. (Sbu) Over the past few days Prime Minister Erdogan and Minister Babacan have made public statements saying the GOT has decided to seek a follow-on disbursing SBA. At a private meeting with an American company which econoff attended, Babacan confirmed that the GOT,s priority in seeking the new program was the IMF seal of approval on their policies, though the financing would also be useful. Turkish press reports have suggested that Babacan had only convinced Erdogan to overrule doubters in the Government by pointing out the risk of higher oil prices to the already-expanding current account deficit. In the meeting with econoffs, Klingen opined that the GOT had also come to realize that, rather than the EU anchor providing a potential substitute for the IMF, an IMF-approved program would strengthen the GOT,s EU accession efforts, by making Turkey a more attractive candidate. A chorus of voices (Central Bank, the leading business groups and the entire financial community) had been calling on the GOT to seek a SBA since late spring, and Klingen told econoffs that GOT economic technocrats were convinced of the need for a SBA for some time, but had yet to obtain the Government,s decision.

Process for new SBA

¶9. (Sbu) Klingen explained that early next month the Fund plans to present a &high access paper8 to the board in accordance with its policy on exceptional access countries. The paper will establish a ceiling for the size of any new program. Provided the board approves of the paper and sanctions the beginning of negotiations, a

mission will come to Ankara during the second week of September. According to Klingen the Turks hope that the mission can agree on the terms of a new program before the World Bank/IMF annual meetings in Washington at the end of that month. In the meantime the GOT has &a lot of homework to do8 as they fill in the empty spaces in their three-year program. Klingen offered that it is not likely that this timeline will be realized. At the western diplomats, briefing, Klingen noted that, if agreement were reached on a new program, the Fund would cancel the last two reviews of the existing SBA and replace them with the first reviews of the new program, with virtually identical conditions. If the two sides take more time to agree, the existing SBA would continue to be in effect.

Current Account, 2005 budget, and Growth

¶10. (Sbu) In the context of the current program, Klingen briefly recounted the dialogue that occurred on the issues of the current account deficit and next year,s budget. On the current account, he pointed out that deficit is already approaching 4 percent of GNP with nearly half the year still to go, albeit the half that includes most tourism receipts. He described the potential fiscal measures that the IMF proposed in the event the deficit continues to widen to the point of necessary action: not spending revenue over performance, passing through high international oil prices, doing away with the current incentive to trade in old cars when purchasing new ones, and resuming F/X purchases on the part of the central bank. At a press conference later the same day, Finance Minister Unakitan revived the earlier, IMF-rejected idea of increasing banks, resource utilization tax, as a means of slowing the import-attracting growth of credit. Unakitan also warned banks against fast credit growth and announced continued strong fiscal performance in July. Klingen, however, noted that the fiscal overperformance*while notable at the central government level--was not so impressive for the entire public sector, because of loss-making parastatals. In the Fund team,s discussions last week, Klingen said the two sides spoke about how to arrive at a 5% (6.5%) primary surplus. Here Klingen commented that it was not clear that the politicians understood exactly what would be entailed in achieving the targets announced in the recent budget call.

¶11. (Sbu) Both Babacan, in the private meeting, and Klingen were very bullish about this year,s GNP growth number coming in well above the 5 percent target. Babacan declined to say a number but seemed not to be in disagreement to a suggestion it would be as high as 7 percent. He said they would not revise the target, however. Klingen, at the diplomats, briefing said real GDP growth could well be between 7 and 8 percent this year, and that assumes a slowdown from the first half.
EDELMAN